



**APPROVED MINUTES  
APPROVED 12-12-11**

**CITY OF SCOTTSDALE  
AUDIT COMMITTEE**

**MONDAY, NOVEMBER 21, 2011**

**CITY HALL  
KIVA CONFERENCE ROOM  
3939 NORTH DRINKWATER BOULEVARD  
SCOTTSDALE, AZ 85251**

**REGULAR MEETING**

**PRESENT:** Chair Suzanne Klapp  
Councilman Robert Littlefield  
Vice Mayor Linda Milhaven

**STAFF:** Dorinda Cline, Finance & Accounting  
Gina Kirklin, Water Resources  
Cherise Moss, Finance & Accounting  
Jennifer Pollock, City Attorney's Office  
David Smith, City Treasurer  
Dan Worth, Public Works  
Joyce Gilbride, City Auditor's Office  
Sharron Walker, City Auditor's Office

**GUESTS:** Don Couvillon, ASU Foundation  
Virginia Foltz, ASU Foundation  
Karen Lyzinski, LarsonAllen  
Carter Smitherman, LarsonAllen  
John Washington, Scottsdale citizen

**CALL TO ORDER**

Chair Klapp called the meeting to order at 4:00 p.m.

**1. Approval of Minutes, Regular Meeting, September 19, 2011**

**VICE MAYOR MILHAVEN MOVED TO APPROVE THE MINUTES OF THE SEPTEMBER 19, 2011 REGULAR MEETING. COUNCILMAN LITTLEFIELD SECONDED THE MOTION, WHICH CARRIED BY A VOTE OF THREE (3) TO ZERO (0).**

**2. Discussion with LarsonAllen LLP Representative regarding the City's Financial and Compliance Audit for FY 2010/2011**

Mr. Carter Smitherman of LarsonAllen introduced Ms. Karen Lyzinski and discussed the audit. He said that both opinion letters are unqualified, clean opinions.

For the single audit report they gave an unqualified opinion on compliance. However, the auditors noted some material weaknesses. Most of the findings relate to the close out process and the transition in personnel. One employee left and another took FMLA leave. Their workload was shifted to other existing staff in the department. He stressed that he did not want to take away anything that staff has done, but he had to point out the reasons for some of the material weaknesses.

City Treasurer David Smith added that one person left who had been responsible for much of the debt management work. The department has addressed this in a couple of ways. All debt related activities are being transferred to Ms. Lee Guillory, the Finance Manager, as it makes sense to consolidate debt-related functions. Staff will focus on doing these tasks on a more timely basis. They will hire an employee to fill the existing position, reporting to Ms. Guillory. Ms. Kirklin will work more closely with Ms. Guillory. He believes these changes will go a long way towards addressing most of LarsonAllen's findings.

Mr. Smitherman noted that their other findings were related to the schedule of expenditure of Federal awards. Issues were found with two programs. One program was not shown on the schedule. He contacted the U.S. Department of Justice for guidance. The program is difficult to identify since it is not listed in any of the reference tools provided by the Federal government. This explained why it had not previously been reported. The second concern was over reporting of Federal expenditures. Some of the expenditures had been funded by other sources.

Mr. Smith explained that the City does not have a lot of accounting capability. He and Mr. Smitherman discussed cross-training. He said that Ms. Kirklin does the accounting for the enterprises and Ms. Cline and Ms. Henthorn are the accountants. Ms. Cline also manages accounts payable while Ms. Henthorn manages payroll. Mr. Smith added that at some point he may come to Council to request additional hires; at this point they have barely enough staff.

Chair Klapp asked how many vacant positions are going to be filled and how many employees are currently on leave. Mr. Smith said they are recruiting someone to work in debt management, as just discussed. The Director of Accounting position is currently vacant and in the recruiting process. One employee is on maternity leave until early December. Mr. Smitherman said the issues found were largely caused by these three

simultaneous vacancies, but it would be irresponsible if he did not discuss this with staff and with the Audit Committee.

Mr. Smitherman thanked his staff and the finance, accounting, and budget staff for all their hard work on the Comprehensive Annual Financial Report (CAFR). The auditors gave it an unqualified opinion. Staff will submit the CAFR to the Government Finance Officers Association for certification.

Vice Mayor Milhaven asked Mr. Smitherman to explain why the financial statements of the component units were not audited in accordance with government auditing standards. Mr. Smitherman said the component units of the Community Facilities Districts, the Scottsdale Preserve Authority, and the Municipal Property Corporation are audited separately. All of these corporations are basically debt entities, so for CAFR purposes, their operations are blended as if they are part of City operations. Each unit also has its own separately issued financial statements that are not issued under government auditing standards (GAS) because there is no grant agreement, contract, or law that requires them to be audited in such a manner. The City has to be audited in accordance with GAS because of grant requirements and the level of Federal money it receives. Because the component units are included but are under different auditing standards, that fact must be disclosed.

Mr. Smitherman added that if the component units would have been audited in accordance with GAS, he does not anticipate there would have been any changes in the planned audit procedures. The difference would have been that he would have asked some additional questions regarding any grants and contract compliance, although these do not apply to the component units. He told the Committee members that in the future they could conduct the component unit audits in accordance with GAS if that is the wish of the Committee.

Mr. Smitherman summarized that the audits for the community facilities districts all received unqualified opinions. One material weakness was detected and a restatement was required. This was as a result of an accrual error. Management has put a procedure in place to prevent this from recurring.

Mr. Smith announced that these reports will be made available online after the meeting.

### **3. Discussion and possible direction to staff regarding Audit Report No. 1212, SkySong Ground Lease Rent**

City Auditor Ms. Sharron Walker said this audit was conducted in order to exercise the City's right to audit the amount of the ground lease rent due to the City. For calendar year 2010 ASUF Scottsdale LLC (ASUF) reported a net loss of about \$2.9 million for SkySong operations. To date the City has not received any rent payments.

The audit recommends some improvements to the City's oversight controls and clarification of certain lease terms. A contract administrator has yet to be assigned to monitor the terms of the ground lease. Since the lease was developed in 2004, several staff involved with developing the agreement have left. During the audit she discovered certain questionable expenses. She explained that these were not unallowable under the terms of the lease but they were not types of expenses that had been stated in the

lease terms. This should be further discussed between City staff and ASUF. Examples of these expenses include termination payments to a couple affiliates, an administrative fee being paid to ASUF and an asset management fee to an affiliate that is calculated using a modified income statement. Ms. Walker added that some definitions of the lease terms need to be clarified. As an example, depreciation and the debt service definition would let asset costs be recovered twice, but ASUF has not included the costs in both.

Public Works Executive Director Dan Worth said staff will be working on the areas noted with ASUF staff. He added that like the Finance Department, his department is trying to replace a position that was lost through downsizing. They need to have the right resources in place to be able to play an active role in managing this lease and other complex, high dollar leases the City has.

Mr. Worth said there are two approaches to defining the allowable expenses. One is to define and agree upon all the individual terms that go into allowable expenses. The other approach is to change the payment structure. ASUF has brought a proposal for a fixed payment schedule to the City which staff is currently evaluating.

In response to a comment by Councilman Littlefield, Mr. Worth said that either approach has to be approved by both ASUF and City Council. Councilman Littlefield opined that the current ambiguity works in favor of the ASU Foundation. Mr. Worth noted ASUF would derive a number of advantages from changing the lease agreement. A fixed payment schedule would enable them to obtain financing for future phases, as it would create some certainty for potential financial partners. Councilman Littlefield stated that under the current lease agreement no rent payments will be made for the foreseeable future, so it is hard to see why the ASU Foundation would agree to a change. Mr. Worth noted that ASUF would not be paying more money because there is a lifetime cap allowing the City to recoup its investment in both the infrastructure and the original land purchase. The current ASUF proposal is a fixed payment schedule by phase so that phases would be paid off as they are built.

Mr. Smith interjected that ASUF is hoping to negotiate some other modifications to the lease. In particular they would like to delay the construction of the next phase by three years. Mr. Worth said he hopes that a possible lease amendment may be ready to bring to Council within two months.

Councilman Littlefield asked how having a contract administrator would enhance the chances of deriving revenue from SkySong. Ms. Walker said it would give an opportunity to clarify and monitor the terms. Councilman Littlefield stated that even had a contract administrator been in place throughout the entire time, they may possibly not have received any rent payments. Ms. Walker agreed, but noted that with a contract administrator in place the City would be more likely to obtain net revenue, but the current proposal is probably better.

Mr. Smith commented that ASUF's net revenues from SkySong are \$3 million while their expenses are \$6 million annually. In that situation there is not much value to having a contract administrator argue about individual expenses. However, if the ASU Foundation is approaching the City with a major contract modification, staff will consider what can be done to improve the agreement.

Councilman Littlefield asked what a contract administrator would cost. Mr. Worth said one staff member in the asset management group is responsible for approximately 90 different leases to which the City is a party. Three years ago a second position was in the budget and he is looking to add that back in. Mr. Worth added that due to the number of leases, some of which are complex and high dollar, the position is needed regardless of what happens with the SkySong lease.

Chair Klapp asked the ASUF representatives if they wanted to add any comments. They indicated they did not.

**4. Discussion and possible direction to staff regarding Taxpayer Problem Resolution Officer Quarterly Report**

In the absence of Ms. Munar, Ms. Walker presented this report. She noted that all areas of the taxpayer surveys are positive, and no taxpayer complaints were received in the quarter.

**5. Discussion and possible direction to staff regarding Audit Follow-Up Quarterly Report**

Ms. Walker presented the audit follow-up quarterly report, noting that the trend of results is steady. The oldest items are starting to drop off the report as progress is made.

**6. Discussion and possible direction to staff regarding status of FY 2011/12 Audit Plan**

Ms. Walker reviewed the current status of the audit plan. She added that for most of the last two or three months two positions have been vacant. Despite that, with extraordinary effort, her staff has managed to keep the audit plan on track. She plans to start recruiting for the vacant positions after the holidays.

**7. Discussion of Agenda Items for Next Audit Committee Meeting**

Chair Klapp noted that Mr. John Washington wished to address the Committee on this item.

Mr. Washington said he has heard rumors that the Cultural Council contract compliance audit will be postponed indefinitely. He strongly encouraged the Committee not to do so, since this audit has already been postponed twice. He thanked Ms. Walker for supplying him with the draft report. From his reading of the draft report, the issues under consideration have been long known to the Cultural Council. These issues include: earmarks of funds, performance measures, open meeting law compliance, and issues for subcontractor vendors doing business with the Cultural Council. He has complained vigorously about the first three issues for almost two years, including to the Contract Administrator. He encouraged the Committee to deal with these issues now. The Cultural Council has resisted complying with known provisions of their contract for some

time. Mr. Washington further advised that the Council should deal with these issues with all due haste.

Chair Klapp noted that this item is on the list for the next meeting to be held on December 12. In response to Chair Klapp's question, Ms. Walker stated that when auditors met with City staff to discuss the draft report, they requested a delay but she did not grant it. Staff would have to appear before the Audit Committee to make their case. She added that the auditors have been in communication with the Cultural Council staff and City staff throughout the audit, so none of the information in the draft report was a surprise. The responses are due by November 30; they were given one additional day. Ms. Walker noted that the Auditor's office has no administrative support and will be under pressure to process everything to post the meeting on time, but they will do that.

Ms. Walker reviewed the draft agenda for the December meeting.

### **Public Comment**

No members of the public wished to address the Committee.

### **Adjournment**

The meeting adjourned at approximately 4:42 p.m.

Respectfully submitted,  
A/V Tronics, Inc. DBA AVTranz.